RICHARD RUSSELL'S DOW THEORY LETTERS INCORPORATED

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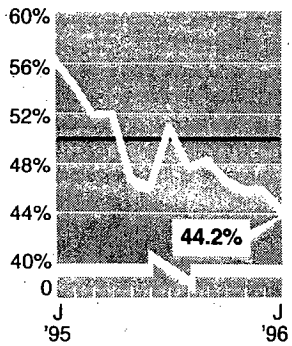
26 Letters Per Year • $250 annually

Feb. 14, 1996 **LETTER 1193**

WHAT'S HAPPENING?: Here's what I think is happening. It's called **stag-flation.** What's stagflation? It's the combination of inflation and a stagnating economy. Consider the following -- the leading economic indicators have been declining for months. The unemployment figures have been rising. The January report of the National Association of Purchasing Managers declined to 44.2 in January, down from 46 in December. Anything below 50 suggests that manufacturing is contracting. The Index has been below 50 ever since last August.

Purchasing managers' index
Below 50% over time signals a shrinking manufacturing economy; below 44.5% over time signals a recession.



Noting all the above, the Fed has dropped the Fed Funds rate twice within a six-week period; they also dropped the discount rate. But what's this? Gold has surged to a five-year high and the CRB Commodities Future has risen to a seven-year high. And the XAU Gold/Silver Average has climbed to its highest level (154) in years. When the precious metals head higher, the markets are at least hinting at "inflation." And why not -- the broad measure of the money supply, M-3, has been advancing at a 6.1% annualized rate.

Now pity the poor devils at the Fed. When the precious metals are rising, the Fed normally boosts interest rates in order to hold back inflation. But there's a problem -- the Fed has just dropped the rates twice! So how can they turn on a dime and raise rates? Furthermore, there's an election coming up, and the Fed almost always "accommodates" the incumbent president by jazzing up the economy prior to election. But in the face of the rising metals, the Fed's hands are now tied. Of course, stag-flation in the year of a presidential election is an excellent environment for a bull market in the metals.

THE CONVENTIONAL WISDOM: In this next section I'm asking, "What are the widely-accepted, *the consensus opinions,* at this time?" Here's my list:

(1) Inflation is under control and will not be a problem for the foreseeable future.

(2) With inflation under control and the economy slowing, buying bonds is a "no brainer" -- so buy bonds and hold 'em.

(3) In today's market stock dividends are relatively unimportant, since many corporations are spending their cash in takeovers or buying back their own shares rather than paying out dividends. Thus the record low 2.19% yield on the Dow is meaningless.

(4) With China and all Asia in a state of rapid economic expansion, the future for world markets could not be brighter. The semi-recessions in Europe and Japan are mere temporary adjustments.

(5) The dollar has seen its lows, and it's now at the beginning of what could be a major bull market (this one is beginning to look wrong already).

(6) The US economy is currently sluggish, but there will be no recession in '96, probably not even in '97. As far as a depression, the Fed would never allow a depression.

Feb. 2 DJIA 5373.99; PTI 4451; A-D Ratio -0.65
Feb. 9 DJIA 5541.62; PTI 4482; A-D Ratio -0.27
Dow Yield: 2.13%; Dow Price/Earnings: 17.5
Dow 200-day MA: 4798; Dow 30-day MA: 5245
Dow Times Book Value: 4.24; PTI 89-day MA: 4372
Percentage of Undervalued Blue-chips: 4%
Gold 200-day MA: 389.48; Gold-PTI: 673

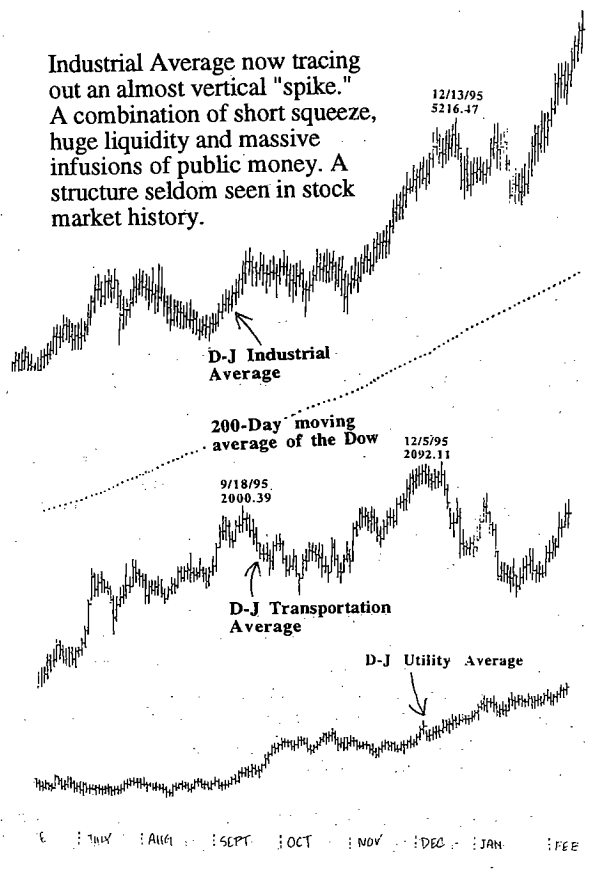
RECESSION UNLIKELY:
The economy will remain sluggish the next six months, but there is little chance of a recession, economists said Monday. Most of the 104 economists surveyed by the National Association of Business Economists expect slow growth. Only 4% expect a recession.

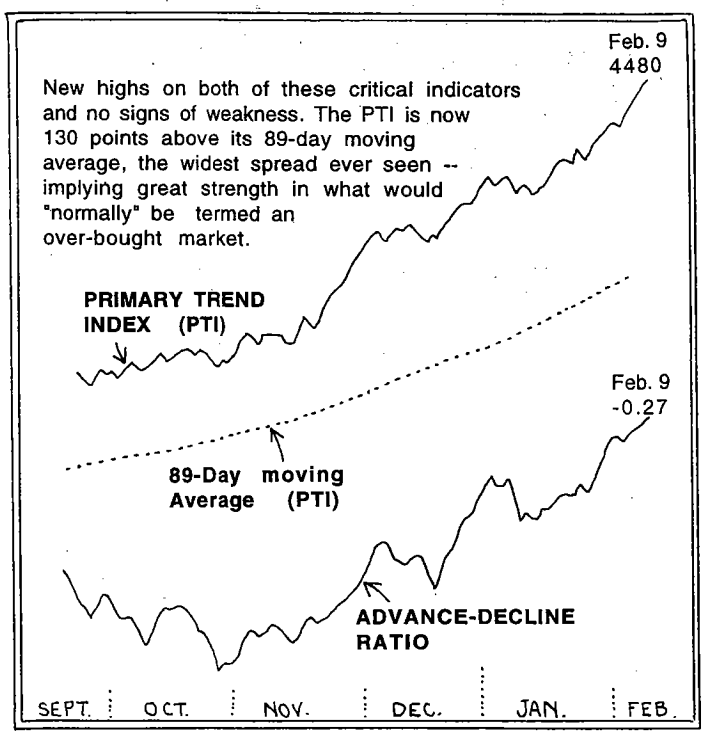
(7) Gold is permanently out of the monetary system. Although gold obviously has value, it will never again back the dollar -- or any other currency for that matter.

(8) Both the Democrats and the Republicans have made concessions on the budget-deficit problem; the US deficits are at last being taken seriously and it's only a matter of time before the whole situation is brought under control (this one's beginning to look like a dream).

(9) Timing the stock market is ineffective and usually costly. The only winning strategy in the stock market is "to buy and hold" for the long term.

All the above are widely believed and accepted, and obviously a few will prove to have been correct. But from a contrary opinion




Feb. 9
4480
New highs on both of these critical indicators and no signs of weakness. The PTI is now 130 points above its 89-day moving average, the widest spread ever seen -- implying great strength in what would "normally" be termed an over-bought market.
PRIMARY TREND INDEX (PTI)
Feb. 9
-0.27
89-Day moving Average (PTI)
ADVANCE-DECLINE RATIO
SEPT.
OCT.
NOV.
DEC.
JAN.
FEB.

standpoint, I think we are entitled to be *skeptical* of all nine of these consensus beliefs.

RUSSELL OPINIONS: In this next section I have outlined a number of the items I am thinking about or have opinions about:

(1) This bull market has clearly been a worldwide phenomenon. It's been driven in part by a global trend of *rising liquidity*. The money (credit) is available and bubbling over, and it has to go somewhere. Where has it been going? It's been flooding into the stock and bond markets of the world.

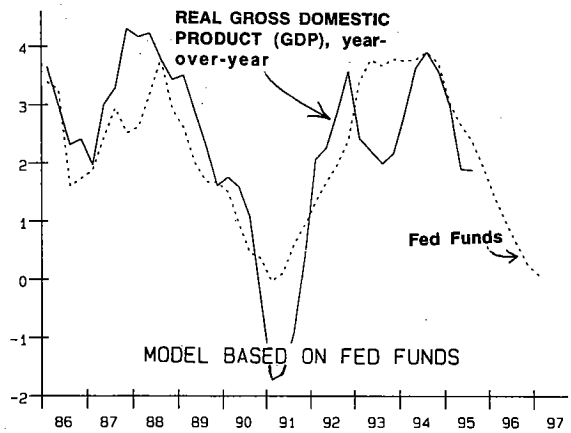
The upside momentum of this bull market has been tremendous. This kind of powerful bull move doesn't tend to reverse on a dime. As a rule, it *takes time to reverse* -- the market must build an extended top before upside momentum subsides. Furthermore, it is well to remember that bull markets don't end on adverse news and they don't end with presidential or central bank warnings; no, they end in only one way -- *exhaustion.*

(2) My **Primary Trend Index (PTI)** has been, in my opinion, the single best barometer of market direction. The PTI has been going up and up month after month, all the while, avoiding false signals and potential "whip-saws." Remember, the PTI cares nothing about values, yields, short interest, odd lots or anything but the **underlying direction of the market**.

(3) I've been drawing attention to the continuing divergence in the action of the D-J Averages. While the Industrials have been surging to new highs, the Transports have failed to confirm. In my experience when divergence occurs, the *more persistent* of the two Averages will lead the way. *So far, the Dow has been the more persistent Average.* (Industrials have been rising to new highs, but Transports have not been breaking to new lows -- the Transport low of January 18 was 1882.11. The fact that the carriers have been following Industrials in direction is bullish.)

(4) A number of deflationary forces are clearly visible in the US economy, one of the most important being corporate downsizing (i.e., the blizzard of pink slips). Counteracting the mild deflationary forces, the US, Europe and Japan have been **re-liquefying** -- pumping up their money supplies. This pumping has tended to "float up" almost everything -- stocks, bonds, gold, silver and even selected real estate.

This chart (courtesy of Ed Hyman and ISI) shows the close correlation between Fed Funds and the economy. If this correlation holds, the US economy will continue to be weak into at least the first quarter of '97.



Debt becomes increasingly difficult to service in a deflationary environment. For this reason, I've maintained that with the amount of debt outstanding in the US (currently $17 trillion), this nation **cannot take deflation** (remember my old warning, "Inflate or die"). Now we're faced with an interesting test. With mild deflationary forces apparent, the *Fed is moving (as it must) to re-inflate* (two declines in Fed Funds and a drop in the discount rate over a six-week period are certainly a start).

(5) The higher the stock market climbs, the more convinced the public is that a primary bear market or even a severe decline is out of the question. Of course, the correct way to view the picture is that there's a **target** somewhere up there (nobody knows at what level), and the market is heading for that target. But, as opposed to the psychology of the public, the professional increasingly respects a market that is climbing relentlessly higher. The professional knows that every 10 points higher is 10 points nearer to the ultimate top.

(6) Last week I talked to Charles Biderman of *Market Trim Tabs* (he's an excellent and original researcher). Charles tells me that although individual income is up, people are not shopping, not hitting the stores. Instead, they've been pouring their earnings and savings into the market. Even those who are laid off have been putting their unemployment money into stocks. Buying stocks and mutual funds has become a national "mania."

(7) Some observers are of the opinion that we are at a watershed period, a period where the tide is turning *in favor of tangible assets* over financial assets (translation "things," houses, commodities, art, jewels, precious metals, will outperform stocks and bonds). My opinion -- it's possible, but I'm not yet convinced. However, last week the CRB Futures Index hit a seven-year high, gold hit a five-year high and silver spurted to near six dollars.

(8) Republican voices against Steve Forbes are reaching a crescendo. He's "filthy rich," he's "buying the election," he's

REGULATE THE RICH!
CURB CAPITALISM!
SAVE THE LITTLE GUY!
MAIN ST. NOT WALL ST.!
DEMOCRATS DENOUNCING BUDGET CUTS?
NO-REPUBLICAN CANDIDATES DENOUNCING STEVE FORBES
B. WASSERMAN FOR THE BOSTON GLOBE

"Richie Rich," he's an amateur, he's a nerd, he's a geek, he has had no experience in government, he can't speak, he's not photogenic, he probably didn't pay his fair share of taxes, he has kooky ideas, and on and on. Yet I wonder, will the public fall for all that nonsense? I can't believe they will. Furthermore, I note that the media and many columnists are now denouncing the flat tax. But again, will the public swallow that malarkey? The flat tax, in my opinion, would be the best thing that could happen to this country, and I suspect that an awful lot of people agree with me. Of course, most of the politicians are satisfied with the IRS and the current progressive tax system. Why shouldn't they -- they give tax favors with it, they thrive on it.

I sense that Dole is fading. At the same time, there's no doubt that Forbes is moving up the ladder. The GOP may not like an "outsider," but they also want to win. So watch Forbes.

CAMPAIGNS: Forbes Gaining

Continued from A1

response to President Clinton's State of the Union address, about a harsh new ad attacking Forbes

Media Chorus Sings Dirge for Dole

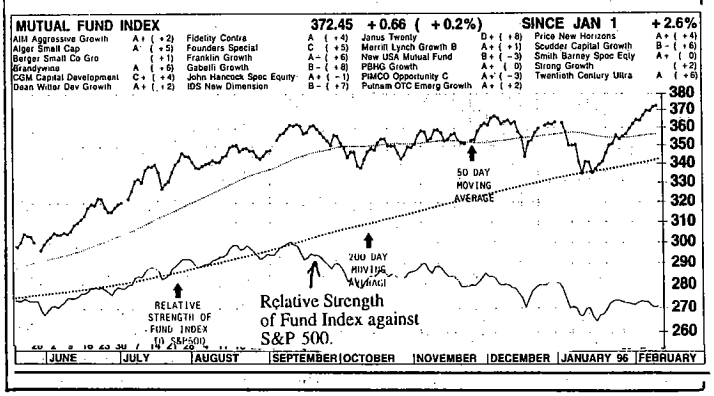
■ **Politics:** Analysts note pack mentality in criticism of GOP front-runner. Coverage of his rival Forbes is less focused.

called the speech Dole's "audition as host for 'Tales From the Crypt.'"

At least some of Dole's problems with the press were probably inevitable, say those who have studied press coverage of campaigns. "There's an element of the media's lying in wait for a story in a

INVESTMENT POSITION: The bull remains in the box, and the primary trend of the market remains bullish. True, the Industrials and Transports have continued to diverge but for an actual danger signal I'd want to see the Dow below 5,000 and the Transports below their January low of 1882.71.

The market is becoming increasingly speculative and dangerous, particularly in view of the continuing divergence in the Averages. I'm including the *Investor's Business Daily's* chart of 23 growth-oriented mutual funds. Note that the Mutual Fund Index is only slightly above its high of last September, five months ago. This tells me that it's become increasingly difficult, even for the top funds, to make money. Note the declining relative strength line. Ever since September the funds have been unable to keep up with the S&P 500. Caution is the stance. Income is the object.


MUTUAL FUND INDEX
372.45 +0.66 (+0.2%)
SINCE JAN 1 +2.6%
50 DAY MOVING AVERAGE
200 DAY MOVING AVERAGE
RELATIVE STRENGTH OF FUND INDEX TO S&P 500
Relative Strength of Fund Index against S&P 500.
JUNE JULY AUGUST SEPTEMBER OCTOBER NOVEMBER DECEMBER JANUARY 96 FEBRUARY

NOTES & QUOTES: In an interview with syndicated columnist David Broder, President Clinton responded, "A president has to be careful how he makes these arguments to the American people because a lot of times in our history, they would prefer having a president of one party and the Congress of the other." Clinton is right on this point -- I've long believed that this is the case. People feel that with a president and Congress in different parties and at odds with each other, *a lot less will get done.* And with government so invasive, dictatorial and generally annoying, voters feel that the less the government gets done, the better off they'll be.

* *

Where To Live: Four of the 10 most expensive cities in the US are located in California. The 10 most expensive are NYC, Honolulu, Wash., DC, Anchorage, LA, New Haven, San Francisco, San Jose, Chicago, and (gulp) San Diego. The 10 cheapest cities are Billings, MT, Corbin, KY, San Antonio, Beloit, WI, South Bend, IN, Columbia, SC, Corvallis, OR, Nashua, NH, Canton, OH, Carbondale, IL. This was based on 200 items in nine categories, including food, clothing, medical, recreation, etc. results released by Runzheimer Int.

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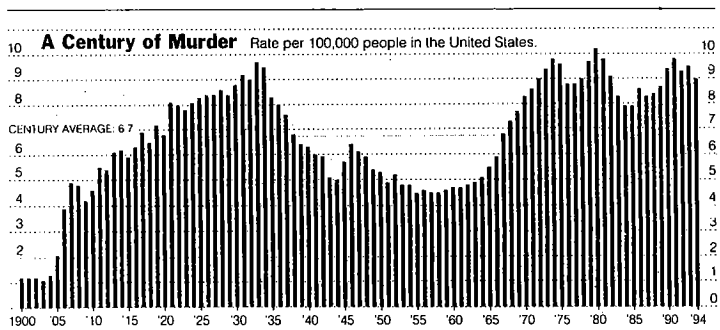
I assume that I have a lot of Jewish subscribers, so the following should be of interest. Before World War II there were 18 million Jews worldwide; now there are only 13 million. The Jewish population is plummeting around the world -- except for Israel, Canada, Panama, Hong Kong and (would you believe) Germany. In the US the percentage of Jews has dropped drastically, from a post WWII high of 4% of the population to the current 2.3% or 5.8 million Jews. Reason -- very high intermarriage rate, very low birthrate. More than half the Jews in the '80s married a non-Jewish partner and of the intermarried couples only 25% raised their children as Jews (statistics from the Israel office of the World Jewish Congress).

* *

This fascinating chart shows the trend of murder in the US since the turn of the century. Note that from 1900 to around 1933 the trend of murder was up. Then during the Depression years until the late-1950s the trend was down. That was the era when I grew up. And yes, it's true. I found the '40s and '50s to be safe (during the '40s I could even go to Harlem at night to listen to jazz without fearing for my life). During the '60s the murder trend turned up (probably due to narcotics), and the murder rate peaked around 1980. The trend took a dip down in the mid-'80s and then back up again into the '90s. The rate seems to be sliding a bit now, probably because the prisons are brimming with criminals and long-sentences are the rule. Note: 80% of the men in prison for narcotics offenses when released return to prison again.


A Century of Murder Rate per 100,000 people in the United States.
CENTURY AVERAGE: 6.7
1900 '05 '10 '15 '20 '25 '30 '35 '40 '45 '50 '55 '60 '65 '70 '75 '80 '85 '90 '94
Sources. Census Bureau, Federal Bureau of Investigation
The New York Times

* *

This fascinating bit of info from the *Int. Herald Tribune:* "America is the tax haven of the world -- provided you're not American," says Barry Spencer, barrister and co-founder of the SCF Group, international tax and immigration consultant with headquarters in London. A 1988 IRS ruling that equated Wyoming-based "limited liability companies" with partnerships stated that non-citizens/residents who do not conduct business in the US have no US tax liability.

* *

Every market has its own language. In Texas during the '70s (are they still talking this way?) if you were really, really rich you talked in terms of how many "units" you owned. A unit was $100 million. Today, in the world of foreign exchange if you are buying or selling yen you talk in terms of a "yard" of yen. A yard = one billion yen.

* *

When I want to know what's going on in NYC I read *New York Magazine* and the *NY Times* (at least they tell me some of what's going on in Gotham). The word is that all financial trends start in NYC, while all social trends start in LA. If you want an insight into what's going on in LA, I suggest you subscribe to the hippest magazine on the West Coast -- **Buzz** [(800)876-7884]. And let me remind you that I never get a nickel out of anything I recommend

(nor, you may have noticed, do I ever include advertising inserts with these Letters).

* *

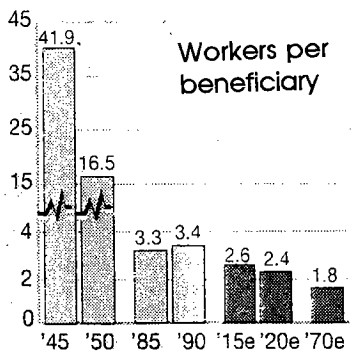
As you pay your taxes, you might think of this: it was just disclosed that the National Reconnaissance Office lost track of $2 billion. This is the agency in charge of building the satellites used by various government agencies to watch over the world. The $2 billion was "lost" said one aide, because of a severe accounting problem which grew from a lack of accountability, in turn created by the extraordinary secrecy under which the Reconnaissance Office works. The office was created in 1960 but its existence was officially denied until 1992. The office is the most secretive of any government agency; it's financed by the $28 billion a year "black budget," and is classified above "top secret." The agency built a headquarter outside Washington, D. C., at a cost of (are you ready) $300 million.

Russell Comment: SECRET means to me that nobody on the outside knows what the hell is going on. Secret means little or no accountability. Speaking of secrecy, the Federal Reserve has never been audited. How much the governors and employees spend, how much they make, what perks the governors enjoy, where they eat -- who knows? Ah, but don't get me started on the Fed.

* *

In the last Letter I referred to the Social Security system as a "Ponzi scheme." If a chart was needed to back that statement, try this one (courtesy of *Investor's Business Daily*). Here we see that the number of workers supporting each SS recipient are fewer and fewer as the years go by. The SS system is simply a huge transfer operation whereby younger workers pay the SS tax, and the money is then transferred to older workers. Problem -- the old-age population is booming. Steve Forbes has the only right idea -- keep the system for today's old-agers, but allow new workers to opt out of the system and set up their own retirement plan.

The number of workers supporting Social Security recipients has plunged



Source: Social Security Board of Trustees

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Free Agency: The following is from the "bible of sports," the weekly *Sporting News* (Feb. 5 issue): "The boys (Cowboys) are back on top of the NFL, but free agency and the salary cap will do to them what the Steelers could not . . . To put it simply, Jerry Jones doesn't have enough money anymore to keep every star on this roster . . . Dallas is the last elite team the NFL will see. 'The destructive effects of free agency, gnawing away at the best and improving the weakest, will see to that,' says Tom Flores, who coached the Raiders to two Super Bowl rings. 'It can close the gap faster than you could in the past. And it's too hard now to keep great teams together. That's why I don't think you'll ever see dynasties anymore.' Even this last dynasty is hanging on now. Far from dominating the Steelers in Super Bowl XXX, the Cowboys needed two timely takeaways to survive the 27-17 triumph. It was a game they should have lost but didn't. They won't be so fortunate in the future."

* *

To my mind, one of the most depressing voyages in the US is the taxi ride from Kennedy Airport to NYC. The scenery along much of the way is reminiscent of a third world country. On top of that, taxi drivers often give out-of-towners the "special scenic tour," which entails rather round-about ways of arriving at the city. To avoid these expensive joy-rides, upon entering a cab I would immediately tell the cabby that "I'm an ex-New Yorker, so do me a favor, take the direct route in." Last month, responding to numerous complaints, the City mandated a flat $30 for the ride from Kennedy to Manhattan. Excellent move.

* *

I just saw a TV program on the serial killer, Ted Bundy. Bundy killed at least 36 women. For years he denied that he had killed anyone. Then when sentenced to death he started to confess, and he named places and times where he had killed dozens of women. It was a classic case of denial. Today O. J. Simpson denies that he killed Nicole or Ron Goldman. To me it's another classic case of denial. Last week Simpson actually denied that he ever hit Nicole, claiming that all he did was defend himself against her attacks. Unbelievable, since we have photos of a battered Nicole, and we have descriptions of O. J.'s attacks in Nicole's diaries. It's simply amazing how certain people will embrace denial. Another example: Clinton's denial of a 12-year sexual affair with Flowers or his denial of his propositioning of Paula Jones. Then we have Hillary's denials regarding Whitewater, and her long list of "I'm unaware" or "I forget." I think that when one's safety or life is on the line the urge to deny becomes overwhelming. Of course, the decent person, the good person, will admit his guilt and take the pain. The PAIN, the consequences, that's what the person hopes to avoid in denial. But the length that some people will go with denial is absolutely amazing.

* *

The following is from an interview in the *NY Times* (Feb. 4) which includes comments by Philip Braverman of DKB Securities: On labor costs: "We happen to be somewhere in the middle on labor costs. The Germans are at the top end of the range somewhere in the neighborhood of $23 to $26 an hour. The Japanese are cost to $20, Americans, $17 an hour and the Chinese at 54 cents. Now in between there are a lot of skilled workers available at $5 an hour in Hong Kong, Korea and Taiwan. But it is inevitable that the Americans, who are competing not only with the Japanese and Germans and in a favorable position relative to that competition, but an unfavorable position relative to most of the rest of the world, are running nervous and scared and are literally losing jobs as production and services gradually shift away . . . The general sense of insecurity that is taking place in the hearts and minds of most American workers is a key element in causing this slowdown in spending. It's not, in a recession, the people who are unemployed that cause the reduction in spending as much as it is the people who are employed that call a halt to postponable spending. And that's what we're beginning to see now."

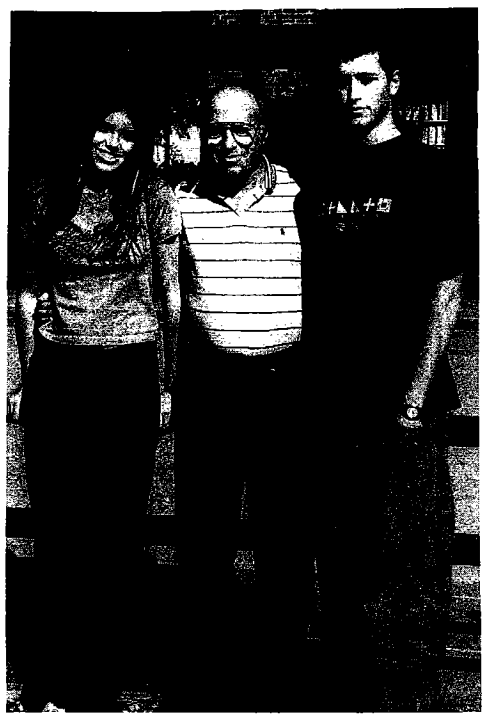
* *

About four years ago I bought a Honda Civic. The car had an interesting history. Someone else bought the car new. Two days after he bought the car it was stolen. The buyer reported the theft to the insurance company and then purchased another car. A day after he had purchased the second car his Honda was found. The car had been stripped of wheels, radio, air conditioning. The insurance company dumped the car to a dealer at a low price. It had only 400 miles on it. I saw an ad for the car and visited the dealer. He had restored the Honda to its original state. I paid him $8,300 for the car (it listed for around $14,000), and I was very happy with it. But about six months ago I sold the Honda to Lynn Hunter, who works here (she's my wife's sister). Last weekend Lynn called me. The Honda had been stolen -- again. The Honda was locked and had a "Club" on the steering wheel. And it was parked right outside Lynn's window. The thief broke in, cut the steering wheel (all without making any noise) and drove off. Amazing. In the meantime, I read about the new Mercedes E320, Motor Trend's "Import Car of the Year" and the Robb Report's "Car of the Year." I visited a dealer, fell in love with the car and bought one (it's the best car by far that I've ever driven). Ah yes, when you lock the new Mercedes it not only locks the doors but it has a mechanism that cuts off the gas and the ignition. My kind of car. P.S.: the Honda was found yesterday in the parking lot of a local high school. It was stripped.

* *

I thought veteran subscribers would get a kick out of the following: You may remember this picture from Letter 740, Oct. 4, 1978. Here we see my seven-month old boy, Ryan, sitting atop my 200 pound mastiff guard dog, Sherman (named after the giant Sherman Tank). Now it's 17 years later, and this is a picture I took last week of Ryan (age 17), me in the middle, and my youngest daughter,

Lauren (age 15). As you can see, they grow 'em big in California. "Little Ryan" is now six foot two and Lauren is an inch taller than her old man. Sheepishly I must admit that I never helped the world as far as zero population growth (I have five kids, aged 15 to 40) but at least I supported them all while they were growing up (one of my four girls is autistic, and I still support her). Current status: one boy, four girls, five grandchildren.



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Last week Jerry Siegel died at the age of 81. Siegel is the fellow who dreamed up the greatest superhero of all time, Superman. Siegel with his partner, Joe Shuster, drew the comic strip, during the '30s -- but the Depression was on and business was slow. In March 1938 the two sold all rights to Superman to DC Comics for $130. Bad sale. Superman became an immediate sensation, but when the two guys sought a share of the money they were told to forget it. The two originators lived the rest of their lives near poverty. In 1978 the first Superman movie was made (it generated a $78 million profit). In all -- TV, movies, comic books, etc., -- Superman made over $1 billion. Finally, bowing to public opinion, DC gave Siegel and his partner, Joe Shuster, an annuity of $20,000 for life, later raised to $30,000. Moral -- when you've got a hot item, give it time, don't sell too soon. And certainly don't sell out for a pittance.

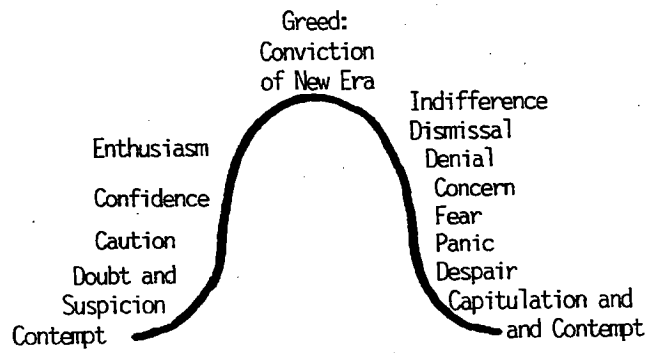
* *

Japan may be the "sick man" of Asia, but China is far from it. China is planning for growth of 9.3% for the rest of this decade, moving to 8% growth thereafter. The target -- to be the world's largest economy by 2030. Unlike the Russians, the Chinese have always had a fierce work ethic. And they are tough and wily businessmen. I take what they say seriously.

Retribution? Did you know that Hillary Clinton worked for eight months on the House Judiciary committee that investigated Richard Nixon?

* *

Jim Benham, CEO of the Benham funds, showed this chart on LA's Channel 22. It's called a "Cycle of Emotion." My friend, Ken Gammage (the *Richland Report* out of La Jolla) copied it remembering the wording as best he could. Where are we now on the cycle? I'm thinking "New Era" is about right.



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Something strange is happening in the developed nations. Their fertility rates are dropping off. The replacement fertility rate is around 2.1, meaning that if a nation's fertility rate is below that number it is probably losing population on balance. Here are the 1991 fertility rates: Ireland -- 2.1; UK -- 1.8; France -- 1.8; US -- 1.8; Canada -- 1.7; Netherlands -- 1.6; Japan -- 1.6; Switzerland -- 1.6; Germany -- 1.4. Now compare those rates with the following: Cambodia -- 4.7; Philippines -- 4.3; Indochina -- 3.5; China -- 2.5. While we're doing aerobics, they're reproducing.

* *

This from retiring Congresswoman Pat Schroeder: "True, the Democrat's biggest failure is that we became the party of government -- *of* the government, *by* the government and *for* the government. We forgot the people. The Republicans' great mistake is that they hate the government -- but they're forgetting the people too. Congress is changing, and most of the retiring Republicans are moderates, which is very troubling. The new breed is smart, and they've learned how to distract people. Part of it is the money. If I were running C-Span, I would put a caption underneath each member detailing how much they've gotten from different industries. You sit there and think, 'Oh, that's the one that got umpty-ump thousand from such-and-such an interest group. It's outrageous.'"

* *

Chrysler has granted a new-car franchise to the used-car superstore operation of giant Circuit City. Auto dealers must be wondering what's happening. My ex-wife, Paula, went to a Cadillac dealer to buy a car. She got their "best price." Then she checked that price with Price Club's price (yes, Price Club sells cars). Price was $2,000 cheaper than Cadillac for the same car. Paula bought the car at Price. **Russell comment:** Remind me not to buy a car dealership. The fact is that the retail business in general is becoming viciously competitive. And to make it even more difficult, American consumers are up to their necks in debt. They're borrowing to keep up the good life.

PRECIOUS METALS: The action of the precious metals continues to be what I term, "tentatively bullish." Last week gold rallied to a five-year high -- then sold off sharply. I was flooded with calls from people who wanted to know, "Why the strength?" "Is it a bull market?" "Should I buy?" "Should I sell?" "Should I buy more?"

First, why the strength? Following are a few possibilities:

(1) The precious metals may sense some inflation, or at least they are responding to the sharp year-to-year increase in the broad money supply. Gold tends to follow the year-to-year trend of M-3.

(2) The metals may simply be reacting to the favorable supply/demand equation. The fact is that over the past four or five years demand has been outpacing supply in both silver and gold. A lot of the demand has been coming from Asia (specifically, India and China), where people like to take possession of physical gold. At present the world's mines are producing only 80% of the gold being taken up by the markets.

(3) Many of the mines have been selling "forward gold" or gold for future delivery at a higher agreed price. This has created additional supply. But recently, the mines have been cutting back on forward selling, which is bullish for gold. On top of that, the central banks seems to have reduced their gold sales.

(4) South African gold production has been sliding while their cost of production has been rising sharply. Average cost of producing gold in S. Africa is a high $325 per ounce. It is estimated that S. African gold production will drop at the rate of 2% a year into the foreseeable future.

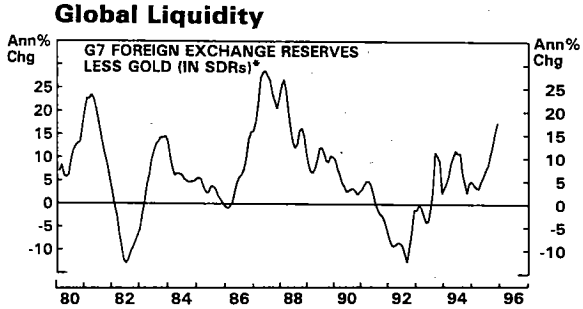
(5) The rise in the metal may be a combination of a few or all of the above. The talk of a "possible US debt default" probably caused many investors to think in terms of the safety of gold. It's at least conceivable that a government could default on its debt (thereby putting the value of its currency in question) -- but it's not possible to default on gold, since it possesses intrinsic value of its own (remember, paper money has zero intrinsic value).

(6) A distant plus for gold lies in Steve Forbes' rise in popularity at the polls, since Forbes is in favor of backing the dollar or tying the dollar in some way with gold.

Gold is a monetary metal. In a precious metals bull market silver also takes on the characteristic of a monetary metal, but in a bear market in precious metals silver takes on the character of an industrial metal.

OK, the questions. Is gold in a bull market? I can't tell yet, but I think there's a good chance that it is. How's that possible, since there's no real visible inflation (of course, there is inflation if you're paying your bills each month, but the government doesn't notice that). Here's a chart from the current issue of the *Bank Credit Analyst,* and what we see here is foreign exchange reserves surging up at about a 17% annualized rate. Keep that up and we'll have world inflation (of course, there IS inflation now -- but it's been in the financials, in the stock markets of the world!). *BCA's* number is (514)499-9706.

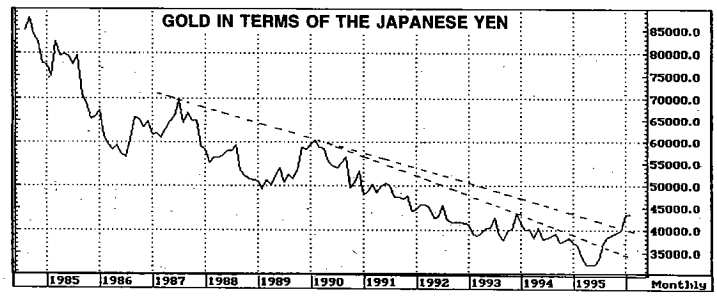
Global Liquidity



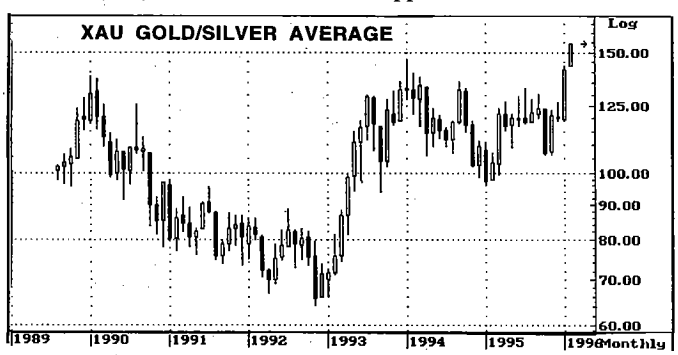
NEXT MAILING: Feb. 28, 1996

Is gold cheap? It's historically cheap when measured against common stocks. At the bottom (left) of the page is a very long-term chart showing gold relative to the S&P. Answer, gold is dirt cheap compared with common stocks. And it's been going down in terms of dollars for years. Chart is courtesy of my friends at *Growth Fund Guide,* Box 6600, Rapid City, South Dakota 57709. (How's the weather been out there, guys? B-r-r-r-r.)

Next on my list -- here's an interesting chart of gold in terms of Japanese yen. Gold has now broken out of a nine-year downtrend. As you can see on the chart, since early 1995 gold has surged in terms of yen. Which undoubtedly accounts for Japanese buying of gold. On top of that, gold has rocketed in terms of the Chinese yuan. And over the last few months, the Indian rupee has lost 15% of its value against dollars. The Chinese and Indians are big buyers of gold.



Gold stocks? Here's a monthly chart of the Philadelphia Gold/Silver Average. It's at its highest level in years, so from this standpoint it looks like a bull market, right? If you bought gold shares in late-1992 or early-1993 with the XAU in the mid-60s you know it's a bull market. After all, XAU is up 130% from its low, and as they say in NYC, "that ain't chopped liver."



One current problem is that with the recent strength in the precious metals, the media has suddenly "discovered" silver and gold. *Barron's* alone was filled with gold talk. Advice regarding buying the metals and the shares came out of the woodwork. There was just *too much bullishness* to suit this market student. The explosion of precious metal talk produced an over-bought situation in gold and silver, and this will have to be worked off. It will be crucially important to see how well the metals hold or how much they back off as they correct. The less they give up on the decline, the more hopeful the situation.

LATE NOTES: Why do I get the feeling that this stock market is "blowing its top"? Here's the way I see it: (1) The primary trend is bullish. (2) There's a near-record short interest on the NYSE. (3) The liquidity "fuel" is feeding the fire -- January figures show that the public poured money into equity funds in the staggering amount (net purchases) of **$24.5 billion,** an amount never seen before. The result: a massive liquidity-driven rise that is taking the Dow and many stocks into "never-never land." The trillion dollar question -- "Will the primary trend of the market remain bullish throughout 1996?" We old-timers still remember that old adage that tells us that "no tree grows to the sky."